

## 1 UNITED STATES DISTRICT COURT

## 2 EASTERN DISTRICT OF NORTH CAROLINA

3 UNITED STATES OF AMERICA, )  
4 Plaintiff, ) DOCKET NO. 5:14-CV-00014-BO  
5 VS. )  
6 FOUR OAKS FINCORP, INC., )  
7 ET AL., )  
8 Defendants. )

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10 TRANSCRIPT OF HEARING ON COMPLAINT  
11 FOR INJUNCTIVE RELIEF AND CIVIL MONEY PENALTIES  
12 BEFORE THE HONORABLE TERRENCE W. BOYLE  
13 THURSDAY, JANUARY 9, 2014; 10:24 A.M.  
14 RALEIGH, NORTH CAROLINA

## 13 FOR THE PLAINTIFF:

14 United States Attorney's Office  
15 By: G. Norman Acker, III, AUSA  
310 New Bern Avenue, Suite 800  
Raleigh, North Carolina 27601

16 United States Department of Justice  
17 Consumer Protection Branch  
By: Joel M. Sweet, AUSA  
450 Fifth Street, N.W., Room 6400 South  
18 Washington, DC 20001

19 Audio Operator: COURT PERSONNEL

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23 JANICE RUSSELL TRANSCRIPTS  
24 1133 TANAGER TRAIL  
VIRGINIA BEACH, VIRGINIA 23451  
25 (757) 422-9089  
trussell131@cox.net

1   **APPEARANCES** (Continued):

2   **FOR THE DEFENDANTS:**

      Smith Anderson

3       By: Clifton L. Brinson, Esq.

          Geoffrey W. Adams, Esq.

4       150 Fayetteville St., Suite 2300  
      Raleigh, North Carolina 27601

5

      Venable LLP

6       By: Jeffrey D. Knowles, Esq.

      575 7th Street, NW

7       Washington, DC 20004

8

9   **ALSO PRESENT:**

10       LISA S. HERRING

      Four Oaks Fincorp, Inc.

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1                                P R O C E E D I N G S

2                    THE COURT:    This is U. S. versus Four Oaks Financial  
3 Corp.

4            So, Mr. Acker, what's the rush?    You showed up with  
5 documents in hand sometime yesterday because "BO" ended up on  
6 the file number, but it could have been any one of five other  
7 Judges who could have been anywhere in or out of North  
8 Carolina, in or out of this District.    And what possible  
9 expectation did you have that you could stick it in front of  
10 the view of a District Judge and you'd walk away with a  
11 signature in the snap of a finger?    That, that would be the  
12 most immediate thing that comes to my mind.

13            MR. ACKER:    Your Honor, we, we filed it.    We --

14            THE COURT:    Just blind hope that I wasn't on the road  
15 or that it didn't go to Judge Howard and he was 500 miles away,  
16 or --

17            MR. ACKER:    Absolutely, Your Honor.    It was -- we  
18 filed it --

19            THE COURT:    So it couldn't be that important.

20            MR. ACKER:    Well, no, Your Honor.    We filed it.    We,  
21 we figured out who the Judge was and --

22            THE COURT:    But you figured that out minutes before  
23 you were at my door.

24            MR. ACKER:    Yes, Your Honor.

25            THE COURT:    Okay.

1 MR. ACKER: That's right. And whoever --

2 THE COURT: Well, suppose it wasn't me. What were you  
3 going to do?

4 MR. ACKER: We were going to contact whoever it was.  
5 Our plan was whoever the Judge assigned to, we were going to  
6 contact.

7 THE COURT: Even if you couldn't get in front of the  
8 Judge?

9 MR. ACKER: Yes, Your Honor.

10 THE COURT: Physically?

11 MR. ACKER: Yes, Your Honor.

12 THE COURT: Were you going to take a jet, a private  
13 jet and fly down to hunt the Judge out?

14 MR. ACKER: No, Your Honor. We were just going to try  
15 to get up with him in the best way we could. We were prepared  
16 to do a telephone conference.

17 THE COURT: And hope that the Judge would just sign  
18 it?

19 MR. ACKER: We were hoping to be, to make ourselves  
20 available to answer any questions that the Judge had in hopes  
21 that it could be done expeditiously, yes, Your Honor.

22 THE COURT: Wow.

23 MR. ACKER: And, and part --

24 THE COURT: That's -- I see that as being as  
25 unrealistic as I can imagine.

1           MR. ACKER: We simply wanted to, to bring it to the  
2 court's attention as soon as we can. I think the --

3           THE COURT: But you didn't put anything on the papers  
4 that said, "Emergency. Life and death. Expedite," or anything  
5 that would have triggered some idea that this was a crisis.

6           MR. ACKER: Your Honor, our -- our plan was -- because  
7 it was a consent order that was being filed simultaneously with  
8 the complaint and because both parties were in agreement that  
9 this consent order was in the, in the interest of the parties  
10 and in the public interest, we --

11          THE COURT: You could cut the court out?

12          MR. ACKER: No. No, Your Honor. We wanted to make --  
13 we wanted to make sure the court was aware as soon as we could  
14 so the court could consider it. And that's why we did what we  
15 did.

16          THE COURT: And so your plaintiff is the United  
17 States, but really, the Department of Justice?

18          MR. ACKER: Yes, Your Honor.

19          THE COURT: It's not the Federal Reserve or the FDIC  
20 or the Comptroller of the Currency or the Treasury Department  
21 or any bank regulatory entity, is it?

22          MR. ACKER: Well, those -- no, Your Honor. The  
23 plaintiff is the United States of America and the Department of  
24 Justice has a --

25          THE COURT: And -- that's because it's a quasi-

1 criminal matter?

2 MR. ACKER: The -- one of the statutes we're going  
3 under is in Title 18 and it provides for an injunction against  
4 fraud and --

5 THE COURT: Criminal behavior.

6 MR. ACKER: Yes, Your Honor.

7 THE COURT: It's wire fraud, is what --

8 MR. ACKER: Yes.

9 THE COURT: -- you're talking about.

10 MR. ACKER: Yes, Your Honor.

11 THE COURT: Okay.

12 MR. ACKER: And the other is a --

13 THE COURT: So does that mean you've got a Grand Jury  
14 going, or you can't tell me that?

15 MR. ACKER: I can't talk about that in open court,  
16 Your Honor, except to say that the proposed consent order does  
17 provide that the Bank will as part of the order cooperate with  
18 any ongoing investigations. And I think --

19 THE COURT: So -- and you can't tell me, either, if  
20 this is a deferred prosecution kind of activity?

21 MR. ACKER: The consent order specifically says that  
22 it does not settle or waive any rights for any criminal  
23 prosecutions of, of anyone.

24 THE COURT: Now you know all about this. You're good  
25 at, on the facts, or not?

1 MR. ACKER: I brought co-counsel with me who is much  
2 more familiar with the facts, Mr. Joel Sweet from the  
3 Department of Justice in Washington.

4 THE COURT: And what section are you in?

5 MR. SWEET: Good morning, Judge.

6 THE COURT: Good morning.

7 MR. SWEET: Joel Sweet. I'm actually an Assistant  
8 U. S. Attorney from Philadelphia.

9 THE COURT: Okay.

10 MR. SWEET: I'm detailed to Washington.

11 THE COURT: Okay. Where, where is your --

12 MR. SWEET: We're in --

13 THE COURT: -- spot?

14 MR. SWEET: I'm detailed to the Consumer Protection  
15 Branch, which is a part of the Civil Division of --

16 THE COURT: Okay.

17 MR. SWEET: -- the Department.

18 THE COURT: Okay.

19 MR. SWEET: And we have both criminal and civil  
20 jurisdiction over certain categories of areas and this is one  
21 of them. And this was our investigation and we've joined with  
22 the U. S. Attorney's Office here to bring it.

23 And, Your Honor, to answer a question that you raised  
24 earlier, we want the court to be fully comfortable with the  
25 status of this, what happened before, what happened after,

1 where it fits in the big picture.

2 THE COURT: Well, that's how you get my signature.

3 MR. SWEET: Well, Your Honor, we want you to be  
4 satisfied that it's a fair, reasonable, and adequate settlement  
5 and that Your Honor is comfortable with the, with putting your  
6 signature on it if the court --

7 THE COURT: Yeah. Well, I'm not going to sign  
8 something that I'm not comfortable with.

9 MR. SWEET: Absolutely.

10 THE COURT: Yeah.

11 MR. SWEET: And that is why --

12 THE COURT: That's the whole idea.

13 MR. SWEET: And that is why, Judge, we have brought it  
14 as a consent decree to have Your Honor's approval as opposed to  
15 a private settlement agreement which would have been an  
16 alternative that would --

17 THE COURT: Sure.

18 MR. SWEET: -- that would have cut the court out.

19 THE COURT: Sure.

20 MR. SWEET: And we don't want to cut the court out and  
21 we'd like Your Honor to consider all the facts. We'd like to  
22 answer all your questions. The questions concerning whether,  
23 where it fits in larger investigations or other investigations,  
24 as Mr. Acker said, we cannot discuss in open court. If Your  
25 Honor is interested in that and wants more information about



1 that before making a decision on the consent decree, we'd be  
2 happy to speak to Your Honor ex parte in camera.

3 THE COURT: Well, I'm not going to do that. I mean,  
4 I'm not going to get involved in some sort of ex parte -- I'm  
5 not here as a Star Chamber, but I'm going to ask the questions  
6 that I feel are compelled.

7 MR. SWEET: Absolutely, Your Honor. We're, we're here  
8 to answer and so are the Bank's counsel.

9 THE COURT: Yeah. And so you know a lot about this  
10 Bank --

11 MR. SWEET: I do.

12 THE COURT: -- and a lot about this activity?

13 MR. SWEET: I do.

14 THE COURT: Okay. This is a -- where is the charter  
15 for this Bank? Where does it come from?

16 MR. SWEET: It's a state-chartered bank.

17 THE COURT: Okay. So the state banking regulatory  
18 agency has issued a charter for this Bank?

19 MR. SWEET: That's correct, North Carolina.

20 THE COURT: And who do you -- and they have federal  
21 insurance?

22 MR. SWEET: They have federal insurance and --

23 THE COURT: So they're under the FDIC and they  
24 participate in the Federal Reserve system?

25 MR. SWEET: Yes, they do.

1 THE COURT: Okay.

2 MR. SWEET: And their, their primary federal regulator  
3 is the Federal Reserve Bank of Richmond.

4 THE COURT: Right.

5 MR. SWEET: So that is the region and that is their  
6 primary regulator.

7 THE COURT: And the FDIC? Doesn't it have  
8 administrative regulatory interest involved?

9 MR. SWEET: It does, but I believe the FDIC in this  
10 case is a secondary regulator, correct?

11 (Inaudible response.)

12 THE COURT: Okay. And so the Federal Reserve Bank in  
13 Richmond is the federal access or federal review?

14 MR. SWEET: Yes. It's the primary federal regulator  
15 as opposed to the OCC or the FDIC.

16 THE COURT: Yeah.

17 MR. SWEET: The banks have choices, in some respects,  
18 of who their regulators will be.

19 Your Honor, in reaching --

20 THE COURT: And this is a private bank? It's not  
21 owned by any other Bank?

22 MR. SWEET: It is publicly held.

23 THE COURT: Yeah.

24 MR. SWEET: It's not owned by another bank. Four Oaks  
25 Fincorp is a holding company.

1 THE COURT: Okay.

2 MR. SWEET: And they own the Bank, itself. The Bank  
3 is an old, established bank.

4 THE COURT: Yeah.

5 MR. SWEET: It's been around since the earlier part of  
6 the last century.

7 THE COURT: Yeah. I've had other litigation involving  
8 this Bank I recall from memory, but I haven't been able to put  
9 my finger on it in the last four to ten years. Somebody else  
10 may remember, but it involved stock and a pledge of stock by  
11 the Bank, what I -- I haven't looked for the file yet.

12 But anyway, I'm familiar with where the Bank is.

13 MR. SWEET: Yeah. And, Your Honor, the only activity  
14 we're looking at with this Bank is what's alleged in the  
15 complaint.

16 THE COURT: Yeah.

17 MR. SWEET: We have no other concerns.

18 THE COURT: So, so this entity with a lot of "Ps" and  
19 a few "Ts" is a clearing house, like PayPal kind of entity?

20 MR. SWEET: No, Your Honor. It's a different sort of  
21 animal and it's -- this is an area that's emerged in the last  
22 six or seven years to be a, these third-party payment  
23 processors, to have a role in the payment system, which, in  
24 some particular cases, can create enormous risks for banks and  
25 for consumers. This is really a --

1           THE COURT: Let's hypothetically say that I've got a  
2 job and my employer pays me every two weeks and I'm broke and I  
3 want to call up or access a payday lender and I make a thousand  
4 dollars every two weeks and I need to borrow \$800 now. And so  
5 how do I get to my payday lender and PPPT? How do I get  
6 involved with them?

7           MR. SWEET: Sure. Let me give you an example, Your  
8 Honor.

9           THE COURT: How about my example? Is that a bad  
10 example?

11          MR. SWEET: Yeah -- no. Let me use your example and  
12 apply it in the courtroom so it might make, it'd be easier for  
13 me to explain and I'll be happy to answer any questions.

14          If I'm the payday lender and you want --

15          THE COURT: I'm the borrower.

16          MR. SWEET: -- and Your Honor is the borrower --

17          THE COURT: Yeah.

18          MR. SWEET: -- they're the bank and they have access  
19 to the payment system.

20          So for me to give you money or for Your Honor to, for me to  
21 get money back, I have to go through a banking system in order  
22 to just have the money moved. And they're, they're the place  
23 it has to happen. The bank is the access to the system, but if  
24 I'm a payday lender and I knock on the door of a bank, even  
25 Four Oaks Bank, and say, "I'm an Internet payday lender. This

1 is the kind of business I do. These are my contracts. This is  
2 what I want to charge in interest and this is how I do my  
3 business," that bank is virtually certain to say, "No. We're  
4 not opening an account for you. We're not putting money into  
5 people's accounts. We're not withdrawing money from people's  
6 accounts. We're not doing that."

7 THE COURT: Because the Fed won't let them?

8 MR. SWEET: Because the regulations and the guidance  
9 to banks about --

10 THE COURT: From the Fed?

11 MR. SWEET: -- risk --

12 MR. SWEET: From the FDIC, the Fed --

13 THE COURT: Okay.

14 MR. SWEET: -- the OCC.

15 THE COURT: And the State Banking Commission?

16 MR. SWEET: And the State Banking Commission,  
17 especially the State Banking Commission.

18 THE COURT: Says, "If you engage in these kinds of  
19 practices, you have a high-risk activity and you're going to be  
20 a bank that's unstable"?

21 MR. SWEET: It's -- exactly. It would be considered  
22 an extremely high-risk customer, high-risk activity that  
23 threatens the bank both legally, reputationally, and  
24 financially.

25 So -- in addition, Your Honor --

1           THE COURT: So in order to do it, if you want to do it  
2 and you want to collect a fee for doing it, you have to set up  
3 a dummy.

4           MR. SWEET: That's right, Your Honor.

5           THE COURT: And the dummy is PPPT?

6           MR. SWEET: Since we're lined up this way I'll say  
7 that Mr. Acker would serve as the third-party payment  
8 processor. So I would have is a lender --

9           THE COURT: So it's a straw transaction, more or less?

10          MR. SWEET: Well, I wouldn't say "straw" because --

11          THE COURT: No.

12          MR. SWEET: -- everybody --

13          THE COURT: It's a dummy transaction where it goes  
14 through there and it gets sanitized.

15          MR. SWEET: Your Honor, I wouldn't want to call it  
16 that because the bank knows who the, who I am except they don't  
17 want to have, they don't want to touch me.

18          THE COURT: It's almost like a money-laundering kind  
19 of thing.

20          MR. SWEET: It's, it's a money transmitter.

21          THE COURT: Okay.

22          MR. SWEET: And I would suggest that your analogy is  
23 apt, but where the bank would not be willing to do business --

24          THE COURT: So if you were a big-time Mexican cartel  
25 drug trafficker and you said, "I have hundreds of millions of

1 dollars, but they're all in cash and I need to put them into  
2 credit," you couldn't go to the bank and say, "I want to open  
3 an account and make this deposit," but you could go to PPP&T  
4 and say, "Here's \$10 million. Open an account in my favor,"  
5 and then put it in Four Oaks Bank.

6 MR. SWEET: It's a type -- that's a type of activity,  
7 Your Honor. If it's -- the bank is able to do business with me  
8 through an intermediary where it could not do business with me  
9 directly. And --

10 THE COURT: Yeah. Who --

11 MR. SWEET: -- in addition, Your Honor --

12 THE COURT: Who owns payday lenders? I mean, is it  
13 the mob? Is it the Mexican cartel? Is --

14 MR. SWEET: That's a great question.

15 THE COURT: You know? Because if this was the '40s  
16 I'd know who owned it. They were all on The Untouchables or on  
17 the later Sopranos.

18 MR. SWEET: Your Honor, the payday lending industry --  
19 and I don't want to speak with generalities --

20 THE COURT: Well, go ahead. I'll --

21 MR. SWEET: -- but there is the payday lending  
22 industry that's brick and mortar that's regulated where you go  
23 to a storefront --

24 THE COURT: Yeah.

25 MR. SWEET: -- and people go in and, for the most

1 part, those entities are known.

2 THE COURT: Yeah.

3 MR. SWEET: The owners are known.

4 THE COURT: Yeah.

5 MR. SWEET: They're legal.

6 THE COURT: Yeah.

7 MR. SWEET: Even if you might not like it --

8 THE COURT: Right.

9 MR. SWEET: -- we're -- we're not -- we're not -- you  
10 know, we're not here telling people what you should do and  
11 what's --

12 THE COURT: Right.

13 MR. SWEET: -- good for you.

14 THE COURT: Even if you don't think 60 percent a month  
15 in interest is healthy.

16 MR. SWEET: If it's, if it's legal, it's your right to  
17 do it.

18 THE COURT: Yeah.

19 MR. SWEET: What the Internet payday lending world is  
20 about --

21 THE COURT: Yeah.

22 MR. SWEET: -- is anonymity.

23 THE COURT: Yeah, but they could be offshore. They  
24 could be in Nigeria. They could be in the Philippines. It  
25 could be anywhere.



1           MR. SWEET: Or, or more so, Your Honor, they can be in  
2 Philadelphia and say that they're in the Philippines.

3           THE COURT: Yeah.

4           MR. SWEET: And, therefore, if they are hauled into  
5 court, they're a foreign company and they're not subject to  
6 U. S. laws, they would say. Now most states would say, many  
7 states would say that, "If you're doing business in our state"  
8 -- and I think North Carolina is one of them -- "then you have  
9 to abide by North Carolina law."

10          THE COURT: So the Internet payday lender is  
11 anonymous --

12          MR. SWEET: Absolutely.

13          THE COURT: -- and their resources are unknown.

14          MR. SWEET: Their resources are significant, but --

15          THE COURT: Yeah, but they're unknown.

16          MR. SWEET: They're unknown.

17          THE COURT: They could be in the millions or tens of  
18 millions or hundreds of millions of dollars. They don't know.

19          MR. SWEET: Absolutely, Your Honor.

20          THE COURT: And the source could be from anything,  
21 from legal, illegal. It could be a way of washing money. It  
22 could be over, you know, foreign currency.

23          MR. SWEET: The source of the money, you're --  
24 absolutely, Your Honor. It -- could be any, anything. Could  
25 be the source of the money and whether taxes are paid on that

1 money, how much money is taken, all of that is -- the activity  
2 of the Internet payday lender is virtually anonymous and --

3 THE COURT: And this gets injected into our banking  
4 and credit system by the introduction of an amount of money to  
5 a borrower unsecured with a pledge of the borrower's pay.

6 MR. SWEET: It's a pledge of the borrower to pay.

7 THE COURT: No. Of the borrower's wage.

8 MR. SWEET: Of his wage.

9 THE COURT: Yeah.

10 MR. SWEET: Now because it's no collateral and because  
11 it's no --

12 THE COURT: Enforcement mechanism to collect the wage.

13 MR. SWEET: Yeah. And -- and --

14 THE COURT: I mean, you can't garnish the wage.

15 MR. SWEET: And frankly, Your Honor, if it's a North  
16 Carolina resident who has this type of loan and they refuse to  
17 pay the loan, that Internet payday lender cannot bring suit in  
18 North Carolina --

19 THE COURT: Right.

20 MR. SWEET: -- against that resident because that loan  
21 is unlawful.

22 THE COURT: Yeah.

23 MR. SWEET: So they have no way to take people's money  
24 back other than automatically getting --

25 THE COURT: Debiting it.

1 MR. SWEET: -- purported preauthorization --

2 THE COURT: Yeah.

3 MR. SWEET: -- which is violations of other statutes.

4 THE COURT: But the money has to get into the account  
5 before the debit can work.

6 MR. SWEET: That's right.

7 So what I will do as a payday lender is when Your Honor  
8 asks for that loan for \$800 I will authorize that debit and I  
9 will send a notice to my processor to originate the ACH  
10 deposit, a credit, that will go to the bank, will go under the  
11 bank sponsorship through the Federal Reserve system, you will  
12 find \$800 in your account. Then I will, I will, based upon the  
13 purported agreement or what we allege fraud in terms of how it  
14 operates, I will then start debiting your account and I will do  
15 it by sending an instruction to my third-party processor to  
16 start to debit your account.

17 THE COURT: And you're debiting it for interest first.

18 MR. SWEET: Exactly, Your Honor.

19 THE COURT: And the interest may eat up the debit?

20 MR. SWEET: What we're finding, Your Honor, is that --

21 THE COURT: And so the principal just remains or is  
22 added to by the delinquent interest.

23 MR. SWEET: Now most borrowers based upon the  
24 representations on the websites they see and even on the  
25 contracts -- in some cases the, the consumer doesn't see the

1 contract -- but they all believe that there is going to be a --  
2 Your Honor would see that you're going to pay -- you borrowed  
3 \$800 and in two weeks you're going to have \$900 withdrawn from  
4 your account.

5 But what happens is they won't withdraw \$900 on one day.  
6 They'll withdraw \$400 in two weeks and it will be applied to  
7 principal and you'll keep on getting debited over and over and  
8 over and over. And we had examples in the complaint, Your  
9 Honor, where -- and this happens regularly to vast numbers of  
10 people -- that \$800 eventually three months down the line has  
11 cost you \$1200 or \$1400 and you still have a \$600 principal  
12 owed. Now --

13 THE COURT: And at the first debit the borrower says,  
14 "Wow. I dodged a bullet. Instead of them taking all the  
15 money, they just took some of the money. So I'm healthy, right  
16 now."

17 MR. SWEET: And, Your Honor, there are -- buried into  
18 the documents -- we've read hundreds of these contracts --  
19 provisions by which a -- we don't, we don't want to speak in  
20 generalities, but there are ways for you, possibly, to avoid  
21 that trap, but it's not something that you will know how to do  
22 or be able to do.

23 THE COURT: The unsophisticated customer is not going  
24 to know how to do it.

25 MR. SWEET: Even the sophisticated customer, Your

1 Honor. You know, sending a letter that's, that reaches the  
2 payday lender two days before the deadline, it's not practical.  
3 Usually, it's not known unless you have the contract itself and  
4 it's long beyond any deadline, but money now is coming out of  
5 your account on a regular basis and you're saying, "What's  
6 going on? I borrowed 8. I've paid 14 and they say I still owe  
7 5." And then, Your Honor, when you're, when you finally close  
8 your account or when you're, you are literally -- we use the  
9 word in the complaint "bled dry" -- you have nothing left.  
10 'Cause these people, for the most part, are working-class  
11 people. These are not the poor people.

12 THE COURT: Right.

13 MR. SWEET: These are not or the people who have  
14 nothing. Because they'll never --

15 THE COURT: 'Cause they can't access food stamps and  
16 other support.

17 MR. SWEET: Well -- well, unless you show that you  
18 have an income --

19 THE COURT: Yeah.

20 MR. SWEET: -- and you're a working person --

21 THE COURT: Yeah.

22 MR. SWEET: -- you don't get the loan in the first  
23 place.

24 THE COURT: Right.

25 MR. SWEET: So what this, these schemes target is,

1 really, middle class and lower middle-class people who are  
2 trying to --

3 THE COURT: Wage earner.

4 MR. SWEET: -- get by.

5 THE COURT: Wage earners.

6 MR. SWEET: Wage earners who, who have jobs, who are  
7 trying to get by and often --

8 THE COURT: How about illegals? Are they brought into  
9 the picture? Because they don't have a Social Security number  
10 and they may not have a checking account. But if they had a  
11 checking account, is that all you need?

12 MR. SWEET: Your Honor, I don't know. I think that  
13 would be a case-by-case determination of whether a lender would  
14 be willing to make an initial loan to someone who, who doesn't  
15 have documentation. I don't know whether the lender would know  
16 that or --

17 THE COURT: What does the lender require, a driver's  
18 license or a Social Security number, or what?

19 MR. SWEET: Usually, a W-2 form, Social Security,  
20 name, address.

21 THE COURT: Well, unless they're off budget, unless  
22 they're under-the-table pay, they're going to get a W-2.

23 MR. SWEET: That's correct, Your Honor.

24 THE COURT: I mean, North Carolina is full of  
25 industries that are employing people who are here illegally,

1 but they are on the books as employees.

2 MR. SWEET: That's a good point, Your Honor. I  
3 never --

4 THE COURT: They have comp. They get --

5 MR. SWEET: Your Honor, I never really looked at that  
6 issue. It's an interesting issue, Your Honor.

7 THE COURT: Yeah. I mean, they -- I mean, we had a  
8 roundup here, one of the pork producers ten years ago -- and I  
9 did it -- and they just bringing them in by the bus. There  
10 wasn't a single person on the line who, I mean, chicken,  
11 turkeys, pork, you name it -- eastern North Carolina's is the  
12 motherload of processing -- there isn't a person in there who's  
13 got legal documentation.

14 MR. SWEET: Yeah. Your Honor, it's interesting you  
15 raise that. There was a case we had against a bank up in  
16 Philadelphia, a criminal case, where -- obviously, I want to be  
17 clear. Not Four Oaks Bank, had nothing to do with Four Oaks  
18 and we're not alleging that kind of conduct --

19 THE COURT: Yeah.

20 MR. SWEET: -- here -- where the bank had an agreement  
21 with a number of its customers who are employers where if a  
22 person came in wearing the T-shirt for that employer they  
23 would --

24 THE COURT: That would I.D. them?

25 MR. SWEET: They wouldn't otherwise I.D. them and they

1 would cash their paychecks.

2 THE COURT: Yeah.

3 MR. SWEET: And the question was whether the bank was  
4 complicit in some type of illegal conduct by --

5 THE COURT: Yeah.

6 MR. SWEET: -- helping and assisting the cashing of  
7 these checks for, that were for illegal employment.

8 But that's another issue.

9 THE COURT: Yeah.

10 MR. SWEET: I just raise it, Your Honor, since you --

11 THE COURT: Yeah.

12 MR. SWEET: -- you raise that question.

13 THE COURT: Yeah.

14 MR. SWEET: So we don't know if that -- we don't have  
15 any, any allegations or anything of that nature there with  
16 regard to immigration status.

17 We know that our victims, for the most, or virtually all of  
18 them, are, we've seen school principals and we've seen 7-11  
19 clerks.

20 THE COURT: So who initiates the contact with Four  
21 Oaks? Is it the PPPT people, the intermediary -- they're  
22 surfing and bottom fishing for a friendly bank -- or is it the  
23 PayPal, the lender?

24 MR. SWEET: No.

25 THE COURT: It's --



1           MR. SWEET: Your Honor, the lender looks for a payment  
2 processor that happens to be able to maintain a bank  
3 relationship.

4           THE COURT: Okay. And -- and so that's the PPPT  
5 people from Texas?

6           MR. SWEET: The Holy Grail for a payment processor is  
7 a bank that's willing to do business with them --

8           THE COURT: Okay.

9           MR. SWEET: -- and their merchants.

10          THE COURT: And turn a blind eye?

11          MR. SWEET: Yeah.

12          And, Your Honor, as we describe in the complaint, there are  
13 a whole lot of federal regulations that come out of the Patriot  
14 Act that require a bank to know if, know who its customers are,  
15 to really understand them, and to know who the principals are,  
16 and to be assured that there's no illicit conduct that their  
17 customer is engaged in.

18          THE COURT: So if go to Wells Fargo, they've got a  
19 screening mechanism and they're going to kick you out and tell  
20 you, "Don't come to us"?

21          MR. SWEET: Absolutely.

22          THE COURT: If you go to the Farmers Bank of Sunbury  
23 and they still don't have a computer, they're liable to say,  
24 "Yeah. How much is the fee that you're willing to pay?"

25          MR. SWEET: Your Honor, I'll give Four Oaks credit. I

1 would imagine that if any of the payment processor's merchants  
2 knocked on the door of Four Oaks Bank and said, "We'd like to  
3 do business with you and have an account and debit people's  
4 accounts," Four Oaks Bank probably would have said, "No way.  
5 We're not getting close to you." However, they will do  
6 business with the payment processor and look the other way.  
7 And that's what happened here, is the signs of fraud were just  
8 glaring.

9 THE COURT: Yeah.

10 MR. SWEET: And as long as they felt removed from it  
11 and we're only looking at the payment processor --

12 THE COURT: So this --

13 MR. SWEET: --- they --

14 THE COURT: -- processor isn't running a hundred  
15 percent of their business through Four Oaks Bank. They're  
16 accessing banks all over America, probably.

17 MR. SWEET: Your Honor, in this particular case we  
18 only know of one at this moment -- and I don't want to go too  
19 far into this -- but at this moment we're not aware of this  
20 particular processor having any other bank relationships and  
21 the Bank may have, counsel for the Bank may have more knowledge  
22 about that. We know that the, this particular processor has  
23 been on notice for months that, that this day was coming and  
24 they certainly have the right, like any other company, to go  
25 out and find a bank that's willing to do business with them.

1 The fact that most banks won't is not the Government's doing  
2 and it's not Four Oaks Bank's doing.

3 THE COURT: Well, payday lending -- let's go back to  
4 the Internet -- payday lending is a escalating crime or plague  
5 on the country, on the economy, you would -- you'd have to  
6 agree. It's not going down. It's going up.

7 MR. SWEET: Well, Your Honor, I'm not sure which way  
8 it's trending right now. There are a lot of financial  
9 institutions that are taking steps to avoid working with high-  
10 risk merchants of all types. And, Your Honor, we're looking  
11 at, we're looking at fraud here. We're looking -- there's a  
12 lot of telemarketers, there are a lot of Internet scammers,  
13 there are a lot of fake pharmacies and offshore Indian  
14 pharmacies, all of these companies involved in those types of  
15 illicit conduct when they, when they are working in illicit  
16 conduct, okay? Not everything is illicit, but where it is  
17 criminal all of them are trying to find access to the U. S.  
18 banking system --

19 THE COURT: Yeah.

20 MR. SWEET: -- so they can get people's money.

21 THE COURT: So what I was going to suggest is Four  
22 Oaks isn't alone in the country in doing this. There must be  
23 other banks in other states that have, repeat the same  
24 experience.

25 MR. SWEET: We're looking for every one of them.

1           THE COURT: Yeah. And they're typically little mom-  
2 and-pop kind of banks?

3           MR. SWEET: Your Honor, my first, my first case of  
4 this nature was a payment processor in Philadelphia. The six  
5 principals of the payment processor were involved and sentenced  
6 and several of them are still in, serving time. This is in 19,  
7 2006. They had -- it wasn't payday lending. It was all sorts  
8 of telemarketing fraud. They were working through Wachovia  
9 Bank. Wachovia had four massive payment processors, each with  
10 hundreds of merchants, and they were doing enormous -- in my --  
11 the particular first case I had there was \$160,000 million of  
12 attempted debits against consumers' accounts in 11 months.

13          THE COURT: How does the bank make money, on a fee  
14 basis?

15          MR. SWEET: On a fee.

16          THE COURT: And the fee is based on the amount of the  
17 debit?

18          MR. SWEET: Good question, Your Honor. Two bases:  
19 They, they take a fee in the same way that it happened in Four  
20 Oaks. They take a fee on the forward transaction and they also  
21 take a fee on the return.

22          THE COURT: Just like a \$2 fee like you get at the  
23 ATM?

24          MR. SWEET: Could be 10 or \$15 on the return. Because  
25 a forward transaction is a, is a normal transaction, but a lot

1 of these transactions as they flow through the system -- and  
2 we'll use Your Honor's example where you're the consumer where,  
3 and your deputy, say, is your, is your bank -- that transaction  
4 hits your, hits your bank.

5 THE COURT: That's where the money's going.

6 MR. SWEET: Yeah.

7 THE COURT: But the money is coming into my bank in  
8 the account?

9 MR. SWEET: Yes, but when, when there's a request for  
10 a debit and it travels from me, the processor, through the  
11 Federal Reserve system, and hits your bank --

12 THE COURT: Yeah.

13 MR. SWEET: -- very often your bank will reject it.

14 THE COURT: Say, "Whoa, stop."

15 MR. SWEET: They'll return it as unauthorized, or for  
16 many other different types of reasons. That leads us into one  
17 of the big red flags, Your Honor, is, is returns and  
18 chargebacks. And what we have here is situation where the  
19 average return for unauthorized is -- it's in our papers -- but  
20 it's .0 something of total return.

21 THE COURT: Yeah.

22 MR. SWEET: And if there are too many returns or total  
23 returns or unauthorized returns or different categories which  
24 we -- I can -- happy to answer Your Honor's questions if you  
25 have any more questions on the types of returns -- high levels

1 of returns are plainly indicia of fraud. Every bit of banking  
2 regulation for a long time has said this, more than ten years,  
3 if a bank sees high rates of return -- and we're talking a half  
4 a percent, 1 percent, 2 percent -- there's a possibility that  
5 the merchant is defrauding consumers.

6 Now in the Visa-MasterCard world where, where a merchant  
7 has returns of over 1 percent, Visa and MasterCard will call  
8 that merchant and say, "Whoa. You're doing something wrong  
9 here. You're on the watch list and if you don't bring the  
10 return level down, you're out. You're out of our system."

11 In the ACH world, the regulatory entity has a threshold  
12 currently at 1 percent for unauthorized returns.

13 It's about to -- there's a proposal out to have a 15  
14 percent threshold for total returns. In other words, Your  
15 Honor, if a store had, it was selling a product and 15 percent  
16 of the time that it tried to do a transaction it got reversed,  
17 there'd be a problem and it's a known problem and the industry  
18 is quite aware of it. These merchants that we're talking about  
19 had return rates of 30 or 40 percent, at least. We've seen  
20 cases where it's 60 or 70 percent. Any bank should immediately  
21 see that and say, "There is something wrong here. We got to  
22 make this stop." However, the bank profits on every one of  
23 those returns and they profit a lot more on the return than  
24 they do on the forward.

25 THE COURT: Who do they get the money from on the

1 return?

2 MR. SWEET: Well, Your Honor, they get -- the charge  
3 that the bank pays, the processor pays --

4 THE COURT: Okay.

5 MR. SWEET: -- and then, ultimately, it comes back to  
6 me, the lender or the merchant.

7 THE COURT: Yeah.

8 MR. SWEET: But if I'm ripping people off, if I'm a  
9 telemarketing merchant, not a -- not a -- let's leave payday  
10 lending aside --

11 THE COURT: Yeah.

12 MR. SWEET: -- I'm a fraudulent telemarketer and I'm  
13 calling you up and getting you to pay 3.99 for something that  
14 doesn't exist --

15 THE COURT: Right.

16 MR. SWEET: -- I don't mind paying a \$15 return.

17 THE COURT: Okay. Yeah, 'cause you got nothing in.

18 MR. SWEET: I've got a pretty good margin.

19 THE COURT: Right, right, right, right.

20 MR. SWEET: That's how the system works.

21 So, so the bank would immediately know from these return  
22 levels that there's definitely a problem and then you're  
23 getting affidavits back from, from banks saying, you know, "I'm  
24 Judge Boyle. I declare under penalty of perjury that the \$200  
25 they took out of my account was not authorized." They're

1 getting hundreds or thousands of these. They -- at one point  
2 this particular bank stopped recording them because there were  
3 so many. So they just loaded them up.

4 I don't want to talk about the particular bank because  
5 that's really not, unless Your Honor wants to hear more about  
6 the specific allegations, but I'm sure Your Honor's familiar  
7 with the complaint. This is some background.

8 So the, the bank sees these enormously high return rates,  
9 which every bit of banking regulations says it's a red flag, a  
10 fraud, they're getting complaints from other banks saying, "Why  
11 are you doing this when people are saying they're not  
12 authorized"? And -- and every -- and every -- and they're  
13 profiting from it. They're getting big fees.

14 THE COURT: Well, how much was the take at Four Oaks  
15 in, over the life of this relationship?

16 MR. SWEET: The total revenue -- and again,  
17 information we received from the Bank and we accept that as, as  
18 accurate, consistent with the findings we've had -- is  
19 somewhere between 8 and \$900,000 of total revenue.

20 THE COURT: Over what period of time?

21 MR. SWEET: 2009 to the present.

22 THE COURT: That's, that's not a lot of money for a  
23 bank. I mean --

24 MR. SWEET: It's, it's not a lot of money, you would  
25 say, given the amount of money that's passing through the Bank,



1 you would say it's not a lot of money. And I agree with you.  
2 In the case with the bank, with Wachovia, it made \$1.8 million  
3 over 11 months for \$165 million of debits.

4 THE COURT: Yeah.

5 MR. SWEET: There's a cost-benefit ratio that every  
6 bank goes through and for this particular bank -- and I'll let  
7 the Bank's counsel speak more directly to this -- in this  
8 particular bank's situation, given the economy and it's last  
9 few years of performance --

10 THE COURT: It was a profit center?

11 MR. SWEET: This was an important profit center.

12 THE COURT: Okay.

13 MR. SWEET: In addition to having the income from  
14 fees, they also had high levels of deposits --

15 THE COURT: As a result of this.

16 MR. SWEET: -- because the money from, coming back and  
17 forth sat in their accounts.

18 THE COURT: Yeah.

19 MR. SWEET: So it gave them capital to work with. And  
20 -- so there were two benefits. And I'm not a banker and the  
21 Bank has a representative here and counsel here. So I'd rather  
22 leave, Your Honor, if it's okay, I'll leave the Bank's  
23 presentation to the Bank -- but I'd be happy to answer any more  
24 questions about how this system works.

25 THE COURT: The, the whole enterprise, not just this

1 payday lender, this particular one, but the Internet credit  
2 enterprise is in the billions of dollars.

3 MR. SWEET: The -- I'm sorry. Which --

4 THE COURT: Well, the, the process that you're talking  
5 about, the telemarketing and --

6 MR. SWEET: Oh. Absolutely, Your Honor.

7 THE COURT: Yeah.

8 MR. SWEET: Tens of billions of dollars.

9 THE COURT: Yeah.

10 MR. SWEET: And I'll say, Your Honor, that, that we  
11 have several government agencies -- and I wish I could say that  
12 every government agency was highly effective in all cases. I  
13 can't because they're not and I'll be the first to admit  
14 that -- but we have the Federal Trade Commission works awfully  
15 hard going after scammers. The -- there are a number of  
16 federal agencies and law enforcement agencies that are  
17 constantly chasing down the originators of these schemes and,  
18 and we're trying to do our best. DOJ goes after them all the  
19 time, but many of those schemes disappear, they're partly based  
20 offshore, and they re-emerge under different names.

21 THE COURT: Yeah.

22 MR. SWEET: And it's, and it's very difficult,  
23 particularly, Your Honor, where it's a telemarketing scammer  
24 where the call might be coming from Canada and, say, we, we get  
25 the perpetrators in court, Your Honor, before Your Honor for

1 trial and, and the victim often has no idea who they spoke to  
2 or even when they spoke.

3 THE COURT: No. I've sentenced people in those  
4 Canadian telephone fraud things.

5 MR. SWEET: So I have nothing I can -- I can --  
6 nothing to inform you, Your Honor, because I'm sure you're much  
7 more familiar with these problems than I am with how it plays  
8 out justice-wise, but the complicit actors in the banking  
9 system is another story and, and, you know, we strongly believe  
10 that where there are actors, whether it's a processor or a bank  
11 that knows that it's facilitating fraud against consumers, we  
12 have a responsibility and a duty and the right to pursue them  
13 and use the appropriate statutes to find a fair and just way  
14 of, of not only stopping that fraudulent system, but also  
15 creating deterrents for others so they, so they're aware that  
16 they, they do have risks if they engage in this activity.

17 THE COURT: I mean, one of the first thoughts I had is  
18 what consequences does the Bank have other than entering into  
19 an injunction? Isn't this the kind of thing where their  
20 charter could be revoked or they could be put on a suspended  
21 list or put on a watch list or something like that?

22 MR. SWEET: Well, Your Honor, a criminal charge would,  
23 would potentially cause a revocation of their charter and would  
24 be an existential threat, I can say, to the Bank. In this  
25 particular situation, we believe that the, the regulators and

1 the State will take serious, take a serious look at what this  
2 means for the Bank. And I don't want to speak for the  
3 regulators because we're not regulators. We're law  
4 enforcement.

5 THE COURT: Right.

6 MR. SWEET: They'll do their thing and the Bank will  
7 have its opportunity to engage with a regulator about this  
8 conduct and they'll go from there.

9 THE COURT: Without pointing any fingers or throwing  
10 any stones, this isn't the kind of thing that a 22-year-old  
11 loan officer trainee can say, "Yeah," you know, "this, let's  
12 set up this account." This has to go up the food chain,  
13 doesn't it, in the Bank?

14 MR. SWEET: Your Honor, this was managed at a very  
15 high level at the Bank.

16 THE COURT: Right. I mean, you don't get the guy in  
17 New Accounts to sit down and say, "Sure, we'll, we'll go the  
18 distance with you."

19 MR. SWEET: It might start that way, Your Honor, with  
20 a hungry relationship manager who, who puts some pressure on,  
21 the bank secrecy officer to let something slide so they can  
22 open an account, but once these things start rolling these are  
23 not minor dollar kind of customers. They're, they're  
24 elaborate. Often, including with this Bank, they require  
25 special staffing and procedures for handling all those

1 returns.

2 THE COURT: Do they have a personal contact with  
3 anybody downstream, the clearinghouse PPPT or the payday  
4 lender? Does a guy come in and say, "Let's get lunch down at  
5 the hamburger stand and talk about my trip," or is it all done  
6 anonymously? You don't know.

7 MR. SWEET: Your Honor, with -- there's -- I can tell  
8 you from the various cases I've seen there's, there's all sorts  
9 of relationships.

10 THE COURT: Uh-huh (indicating an affirmative  
11 response.)

12 MR. SWEET: There's all sorts of relationships. I --  
13 I --

14 THE COURT: What was the situation here?

15 MR. SWEET: The situation here -- you're asking, Your  
16 Honor, the relationship within the Bank?

17 THE COURT: Like did the Bank ever physically look at  
18 a human being who was the clearinghouse person and who came --

19 MR. SWEET: Depositor.

20 THE COURT: Yeah. -- and came in and sat down and  
21 said, you know, "We're, we're so happy to be doing business  
22 with you. This is a nice bank. I like your town"? And also,  
23 the payday lender guy?

24 MR. SWEET: Your Honor, I -- with this, I'd request  
25 your indulgence to defer to counsel for the Bank.

1 THE COURT: Okay.

2 MR. SWEET: I, I don't want to go beyond what's in the  
3 complaint.

4 THE COURT: Okay.

5 MR. SWEET: And we haven't made those allegations in  
6 the complaint. We do have, as I mentioned before, this is, as  
7 Mr. Acker mentioned, this is a resolution of the civil part of  
8 this case against this Bank.

9 THE COURT: Yeah.

10 MR. SWEET: And I'd rather not go any further in terms  
11 of discussing other information --

12 THE COURT: That's fine.

13 MR. SWEET: -- we may have.

14 THE COURT: That's fine. How many of these do you  
15 have going? I mean, is this the only one in the country, or do  
16 you have a hundred of them, or do you have a thousand of them?

17 MR. SWEET: We have several.

18 THE COURT: Okay. Is this a big one, or a little one,  
19 or medium size, small, pocket change?

20 MR. SWEET: We're still trying to assess.

21 THE COURT: Okay.

22 MR. SWEET: There are, there are banks that we are  
23 aware of that have dozens. There are massive national banks  
24 that have, put it this way, more than 25 payment processors  
25 where the payment processor's customers are a majority high

1 risk.

2 THE COURT: Either telemarketer or a payday-lender  
3 kind of thing.

4 THE COURT: Yes. Or Internet. Some kind of --  
5 whatever the --

6 THE COURT: Yeah.

7 MR. SWEET: There's a category -- I think we have them  
8 in a footnote, Your Honor, where we describe what, what the  
9 banking regulators describe as high-risk merchants. I -- I --

10 So I want to give Your Honor some scale. This is not the  
11 only case. It's not the smallest case. It's not the biggest  
12 case, but it's one case, Your Honor, which I can say that Four  
13 Oaks Bank when it received our subpoena back in, I believe it  
14 was May, I think they came to terms with what was happening and  
15 were very forthright in coming to the Government and addressing  
16 the problem. And --

17 THE COURT: Well, you get a subpoena from the DOJ,  
18 that's, that's a little more intense than any of the bank  
19 regulators. I mean, you're used to dealing with the bank  
20 regulators and the auditors. When the guy knocks on your door  
21 from Washington and it's got a criminal potential, you take  
22 that seriously.

23 MR. SWEET: Well, I think the Bank did in this case.  
24 I think the Bank's conduct once it received a subpoena and how  
25 it addressed the investigation at that point is commendable and

1 -- and is -- it's part of the reason we were able to reach this  
2 type of agreement, which, which if Your Honor would like me, I  
3 can talk about the agreement for a moment, but we believe this  
4 is a carefully, narrowly tailored agreement designed to stop  
5 prospectively precisely the illegal conduct that we're  
6 concerned about that will not affect the Bank's other business  
7 and/or its legitimate merchants and customers of which there  
8 are many.

9 We believe that the penalty amounts are, are justified by  
10 the Bank's ability to pay and we can talk more about that, but  
11 we made inquiries and conferred with the state regulators and  
12 the Fed who, and we've, we've done an independent financial  
13 analysis, and we believe that the penalties are appropriate.  
14 They were also within the range of the FIRREA statute.

15 And so between the prospective conduct -- and there is a  
16 provision for a management lookback -- the -- we've, we've  
17 incorporated industry guidelines, merchant industry guidelines  
18 for the return rates and conduct that will have to be driven in  
19 the future by return rates and by other indicia of fraud.

20 So we worked very hard with counsel and come up with what  
21 we believe is an appropriate consent decree. And I will  
22 mention as well, although I'm not as familiar with counsel from  
23 Smith Anderson, Mr. Knowles, who's representing the Bank, is an  
24 extremely experienced lawyer in this area with a national  
25 reputation and I think that the Bank had extraordinarily good



1 counsel in terms of achieving a result that is good for the  
2 public and the Bank.

3 THE COURT: Why doesn't the Bank just simply  
4 terminate all dealings with facilitators?

5 MR. SWEET: Your Honor, I'll let the Bank speak for  
6 itself, if I may?

7 THE COURT: Yeah. Okay.

8 MR. SWEET: Any --

9 THE COURT: All right. Thank you for your  
10 presentation.

11 MR. SWEET: Anything further?

12 THE COURT: I don't know. I'll --

13 MR. SWEET: I'll be here.

14 THE COURT: I'll see.

15 Who's going to, who's going to talk for the Bank?

16 MR. BRINSON: Your Honor, Cliff Brinson of Smith  
17 Anderson. I'm not the person's who's going to talk. I just  
18 want to introduce the person who is.

19 THE COURT: Okay.

20 MR. BRINSON: Jeff Knowles is with the Venable law  
21 firm in DC. He has been handling this matter on behalf of the  
22 Bank and his firm since the subpoena was issued and I think  
23 would be the person most likely to be able to answer Your  
24 Honor's questions.

25 We also have with us, Your Honor, Lisa Herring, who's the

1 Executive Vice President with Four Oaks Bank, and Geoff Adams,  
2 who is one of my partners as well

3 THE COURT: Yeah. Didn't I have a case involving Four  
4 Oaks Bank? Does your Bank representative remember that?

5 MS. HERRING: No, I do not remember.

6 THE COURT: Okay. All right. We'll keep looking for  
7 it.

8 Mr. Knowles? Well, do you want to say anything,  
9 Mr. Knowles?

10 MR. KNOWLES: Your Honor, I'd be happy to answer any  
11 questions that you have.

12 I'd also be happy to give you some of the context around  
13 what this case is going on. There's a lot to it and --

14 THE COURT: Why did your company get into this if it  
15 was with a bunch of crooks?

16 MR. KNOWLES: Well, I, I would kind of dispute the  
17 characterization because it's a much more complex process and  
18 if I could, Your Honor, just step back for a minute and give  
19 you a little bit of just history here.

20 THE COURT: Well, payday lenders go back to Al Capone,  
21 you know. I mean, it's -- that was the idea --

22 MR. KNOWLES: They -- they --

23 THE COURT: -- you know, loan sharking, they called  
24 it.

25 MR. KNOWLES: They do, but it's a little different

1    than that.

2               THE COURT:   They used to call it "loan sharking."   Now  
3   they have a more elaborate description.

4               MR. KNOWLES:   You're right, but there's a difference,  
5   you know.   This industry is also called small-dollar loans.

6               THE COURT:   Yeah.

7               MR. KNOWLES:   And it's very difficult for a lot of  
8   working people to go to a bank, to go to a Wells Fargo or a  
9   local bank and get a small loan, a \$500 loan.   This is an  
10   industry that sprung up because there's a real need and, in  
11   fact, when the Federal Government shut down in Washington there  
12   were stories about government employees going out and getting  
13   payday loans.   There are a number of reasons why working people  
14   can't get access.   They have that.

15              So there's a real need for the service.   The question is  
16   how that need that people have for small short-dollar loans, to  
17   fix a car, do something else, all those things that are  
18   serviced.   And there are -- and I think Mr. Sweet pointed this  
19   out -- lawful payday lenders, storefront lenders, and others  
20   who are complying with all the relevant state and federal laws  
21   in the area.

22              So I think the point that Mr. Sweet was making is that the  
23   Department of Justice is not trying to throw the baby out with  
24   the bath water.

25              THE COURT:   It -- it --

1           MR. KNOWLES: They're trying to get the bad actors out  
2 of this.

3           THE COURT: It's tough to put a good face on predatory  
4 lending, though. I mean, that's -- this is going to be a hard  
5 sale here, you know?

6           MR. KNOWLES: Well, I'm not going to, I'm not going to  
7 try to explain. I think it would take a long time to give you  
8 a full discourse on, on that. So I won't do that, but there  
9 are some points that I do want to make, Your Honor.

10          This is a fair settlement that was carefully negotiated and  
11 entered into, as Mr. Sweet said. And I'm happy to answer any  
12 questions about the settlement, itself, but I do want to just  
13 make a couple of comments about the Bank, itself.

14          THE COURT: Well, if you're not doing it anymore and  
15 if you've knelt down and asked for forgiveness, why do you need  
16 to have any sort of agreement at all? Why don't you just --

17          MR. KNOWLES: Well, that's -- that -- that's a good  
18 question.

19          THE COURT: Why don't you just give it up?

20          MR. KNOWLES: That's a good question. The fact of the  
21 matter is before this subpoena came from the Department of  
22 Justice and they came in -- and, Your Honor, in Washington we  
23 deal with, our area, we do a tremendous amount of enforcement  
24 work dealing with government investigations across the entire  
25 spectrum of the Federal Government as well as State Attorney

1 Generals and we enter into many settlements for cases for many  
2 different reasons.

3 But an important fact that you should be aware of is that  
4 the Bank tried to terminate this agreement in the fall of 2012.

5 THE COURT: And the payday lenders wouldn't let them?

6 MR. KNOWLES: Would not let them. And part of the  
7 problem was -- and so well before the --

8 THE COURT: Did --

9 MR. KNOWLES: -- Department of Justice --

10 THE COURT: Did they threaten --

11 MR. KNOWLES: -- ever showed up --

12 THE COURT: Did they threaten their lives? Did they  
13 send --

14 MR. KNOWLES: That's exactly --

15 THE COURT: -- some of the --

16 MR. KNOWLES: That's exactly --

17 THE COURT: -- some of the "boys" over?

18 MR. KNOWLES: -- what happened. That's exactly what  
19 happened. Unfortunately --

20 THE COURT: So it is the mob?

21 MR. KNOWLES: -- and we, we were not counsel at the  
22 time, nor was --

23 THE COURT: It is the mob.

24 MR. KNOWLES: -- Smith Anderson -- but when we gave  
25 notice of termination the third-party payment processor took

1 strong exception to that --

2 THE COURT: And said, "You're in it for the life."

3 MR. KNOWLES: You said, "You're stuck," and the  
4 contract, unfortunately, looked more like a straitjacket. And  
5 -- but the Bank very much wanted to extricate itself from that  
6 relationship.

7 THE COURT: They sent you the collected series of The  
8 Sopranos so you could watch all the years from --

9 MR. KNOWLES: Well --

10 THE COURT: -- 1 to 9?

11 MR. KNOWLES: -- without characterizing it, let's say  
12 that the Bank did not continue that relationship happily. And  
13 so it's very clear that long before --

14 THE COURT: I've never heard of a --

15 MR. KNOWLES: -- the Department of Justice came by --

16 THE COURT: I've never heard of a bank being the  
17 victim of extortion. Usually, the bank is the, the source of  
18 the extortion.

19 MR. KNOWLES: Well, this is the case --

20 THE COURT: They were wearing the wrong hat here.

21 MR. KNOWLES: Yeah.

22 Two things. One here, this is a case where the Bank was  
23 doing, I think, a good job on due diligence. Was it perfect?  
24 No. Are there examples that the Department of Justice has  
25 cited? Yes. But to that point, we do understand the

1 complexities and these issues have come to the fore really in  
2 the last few years.

3 THE COURT: Well, let's indict these payday lenders  
4 here for, for their collusive crimes and extortion and  
5 racketeering. This is a great RICO case, isn't it? You're a  
6 U. S. Attorney, right? You're too young to be a RICO guy, but  
7 I'm old enough to be a RICO. This is a classic RICO case.

8 MR. SWEET: Your Honor, I wrote my, my Law Review Note  
9 on RICO.

10 THE COURT: Am I not right?

11 MR. SWEET: I, I appreciate your comments.

12 THE COURT: About being young?

13 MR. SWEET: I'm not sure you're correct about that,  
14 but I, I generally don't want to --

15 THE COURT: But the RICO --

16 MR. SWEET: -- sound --

17 THE COURT: -- application is spot on, isn't it?

18 MR. SWEET: Your Honor, I think that's something that  
19 is worthy of consideration.

20 THE COURT: Is Blakely still alive? That --

21 MR. SWEET: I don't believe so.

22 THE COURT: You don't think so. I think he died.

23 MR. SWEET: He was at Notre Dame.

24 THE COURT: Yeah.

25 MR. SWEET: And I don't --

1 THE COURT: He wrote the law.

2 MR. SWEET: Yeah. And I, I don't think he is --

3 THE COURT: Yeah.

4 MR. SWEET: -- unfortunately.

5 THE COURT: Yeah.

6 MR. SWEET: But --

7 THE COURT: Yeah.

8 MR. SWEET: But it was a brilliant law when it was  
9 written.

10 THE COURT: Yeah.

11 MR. SWEET: And it's got some --

12 THE COURT: I actually tried some criminal RICO cases.  
13 They're --

14 MR. SWEET: Your Honor, I hear what you're saying and  
15 I'll make sure that this, your commentary --

16 THE COURT: It's still a law, isn't it? It -- it's --  
17 it hasn't been repealed, has it?

18 MR. SWEET: No.

19 THE COURT: No.

20 MR. SWEET: No. As a matter of fact, Your Honor --  
21 and this is --

22 THE COURT: They, they get to take the bank under  
23 RICO. I don't know if you've had experience with it.

24 MR. SWEET: I -- I am --

25 THE COURT: You just --



1 MR. SWEET: I am old enough to have had --

2 THE COURT: You, you give it all up, right?

3 MR. SWEET: -- quite a bit of experience with RICO and  
4 I don't think that the facts in this case warrant RICO.

5 THE COURT: No, I know.

6 MR. SWEET: Your Honor, not referring to this Bank at  
7 all or this investigation at all, purely as a theoretical --

8 THE COURT: Theoretical, yeah.

9 MR. SWEET: -- response to what you've discussed, what  
10 you just mentioned, the RICO statute does have a specific  
11 identifiable provision.

12 THE COURT: Predatory --

13 MR. SWEET: It is, it is a RICO violation to collect  
14 an unlawful debt and -- and there -- once you have that, a lot  
15 of the other provisions drop away.

16 So I will, I will point that out that there are issues  
17 there that you raise and I think consider, are worthy of  
18 consideration.

19 MR. ACKER: There are also statutes, Your Honor, that  
20 prohibit, federal statutes that prohibit lenders from engaging  
21 in certain loan practices or similar practices if the State  
22 requires a license to participate in those without a license.  
23 And that is, certainly, another avenue that is being explored.

24 THE COURT: Don't you wish I had just signed this  
25 thing yesterday and it never saw the light of day, just sort of

1 flew through the hallway?

2 MR. KNOWLES: No. What -- I do agree with what the  
3 Government said, Your Honor.

4 THE COURT: Okay.

5 MR. KNOWLES: We certainly want to make sure you're  
6 comfortable with all the facts --

7 THE COURT: Sure.

8 MR. KNOWLES: -- and that you are able to get answers  
9 for any questions you have.

10 I would note, you know, a couple of different points just,  
11 you know, quickly.

12 You can debate the merits of the industry. Clearly,  
13 there's a need for people to get access to money and the rates,  
14 interest rates are, you know, that's an issue, but Four Oaks,  
15 you know, in this situation, this is something that's come to  
16 attention really in relatively recent years. The Wachovia case  
17 in 2008, which led to a very large, \$160 million, \$150 million  
18 civil penalty, one of the largest that OCC had ever meted out,  
19 I was involved in that case because we later represented  
20 Wachovia and some of their executives, but I also was involved  
21 in some of the underlying merchants that led to that particular  
22 OCC penalty.

23 THE COURT: In 2008 --

24 MR. KNOWLES: This --

25 THE COURT: -- Wachovia wasn't worth, given \$2 to --

1 its stock had gone from 70 to nothing.

2 MR. KNOWLES: It had, but it was still a major case at  
3 the time. And the point is that there's been an increased  
4 amount of attention that the Government has put on this because  
5 of -- there's a group called the Federal Financial Fraud  
6 Enforcement Task Force coordinated by the Department of Justice  
7 with an array of all the banking agencies that you talked about  
8 and they have in the last few years really begun to focus on  
9 third-party payment processors and their role. And the  
10 Government's investigation has been dubbed "Operation Choke  
11 Point." And the idea behind it, Your Honor, is to try to close  
12 off access to the U. S. financial system by putting pressure on  
13 third-party payment processors and banks that deal with third-  
14 party payment processors.

15 And so every bank in the country, large and small -- this  
16 is not a problem of banks like Four Oaks alone. We could be  
17 talking about Wells Fargo, JPMorgan Chase, BMO Harris, any  
18 number of other banks. And so it's a problem, generally. The  
19 awareness, the reputational risks, financial risks, legal risks  
20 are, those issues have been there, but the particular focus and  
21 the awareness now is greater than ever. Cases like JPMorgan,  
22 they're well publicized and the need to, you know --

23 THE COURT: They just coughed up a couple of billion  
24 to --

25 MR. KNOWLES: Absolutely.

1 THE COURT: -- to the Ponzi --

2 MR. KNOWLES: That's right. And they went through  
3 their commercial customers, just as Mr. Sweet said. They have  
4 gone through and looked at their commercial accounts and  
5 they're getting rid of a number of high-risk commercial  
6 accounts.

7 So this awareness is really coming lately. The Government  
8 is driving it. All the regulators are driving it. DOJ as a  
9 law enforcement agency is pushing that agenda. There's very  
10 close coordination among all the government agencies, Federal  
11 Trade Commission, Consumer Financial Protection Bureau, and so  
12 forth, but the industry as well. Banks are paying attention to  
13 this. They are responding. When Four Oaks became aware of  
14 this, before the Department of Justice arrived, they wanted to  
15 do the right thing. They were very concerned that if they  
16 wound up in protracted litigation with this particular third-  
17 party payment processor, that it could damage the Bank and  
18 ultimately create massive financial liability for the Bank  
19 because of the way the original contract was written. But they  
20 understood that. They wanted to get out and as part of the  
21 agreement they would be terminating that relationship. But  
22 that's not an understanding that was reached just because of  
23 the Government's actions.

24 The Bank wanted to get out of this, you know, going back to  
25 the fall of 2012 and, in fact, at the time the Bank entered

1 into business with this particular third-party payment  
2 processor the relationship changed over time. And one of the  
3 things with third-party payment processors, they may have as  
4 their merchant base -- they have merchants or clients of their  
5 own -- and they could have had a thousand drycleaners or a  
6 thousand liquor stores or a thousand restaurants.

7 THE COURT: Yeah, but this one had 99.9 percent of  
8 payday lenders.

9 MR. KNOWLES: It changed over time and the nature of  
10 the merchants that that third-party payment processor was  
11 servicing changed over time.

12 So it began to change and as it began to change over time,  
13 Your Honor, the Bank became increasingly more uncomfortable  
14 with the relationship and concluded on its own in the fall of  
15 2012 that it wanted to terminate that relationship. Department  
16 of Justice understands that. We've had many conversations  
17 about it.

18 So the Bank has today -- hindsight is perfect. We all know  
19 that -- the Bank has a much clearer understanding today of what  
20 the concerns are that the Government has, what the potential  
21 harm is to consumers from a consumer injury standpoint, and I  
22 think the Bank acted, you know, at the time in accordance with  
23 standards that were out there. You know, using hindsight as  
24 the test, though, clearly the Government has raised the bar  
25 across the board. All the regulators are raising the bar.

1 OCC, FDIC have put out, you know, guidance documents and so the  
2 bar's been raised. Hopefully, the financial services industry  
3 is paying attention. I know that Four Oaks is paying  
4 attention.

5 And so we think that this settlement is a good way to bring  
6 this issue to a close, to allow the Bank to move forward. The  
7 Bank is getting out of the payment processing business  
8 entirely. And so over a phased period they're dropping one  
9 particular payment processor and within the next year another  
10 payment processor they're working with, they will terminate  
11 that relationship as well and they're very, you know, there are  
12 specific requirements in the agreement dealing with that other  
13 payment processor.

14 But we think this is a good settlement. We think it's a  
15 fair settlement. We hope you'll approve it, Your Honor. And,  
16 and if you have more questions, please feel free to ask.

17 THE COURT: No. Thank you.

18 MR. SWEET: Your Honor, if I may, there was one  
19 statement I'd just like to make with regard to that last issue  
20 that Mr. Knowles raised.

21 The Bank has that decision to get out of the entire  
22 business and will be phasing out other relationships, but under  
23 the provisions of this consent decree the particular payment  
24 processor fits into the -- would be -- would be terminated  
25 under the consent decree. It's -- the moment that it's entered

1 and becomes effective, that particular payment processor that  
2 the case is based upon is gone. The processors that  
3 Mr. Knowles talks about, or the one processor is there is  
4 really -- there are mechanisms here, very stringent mechanisms  
5 to assure that that processor does not engage in the kind of  
6 conduct that we're concerned about that could be harmful to  
7 consumers.

8       So although Mr. Knowles said there's a gradual getting out  
9 of that business, consumers will be protected as of the entry  
10 of this consent decree due to the other provisions. I can  
11 point them out, if Your Honor is interested, but we're leaving  
12 no risk to consumers once, once this is entered because the  
13 existing payment processor will be, really, fenced in in a way  
14 that, I think, the public will be protected.

15           THE COURT: Well -- go ahead.

16           MR. ACKER: Your Honor, I just had one other small  
17 matter to address in the consent, or the proposed consent order  
18 on Page 14, bottom of Page 13 and onto Page 14. One of the  
19 requirements is for the Bank to submit to the court the name of  
20 an outside counsel that the Bank has agreed should conduct an  
21 internal investigation and make recommendations to the board of  
22 directors. And the way this is written, the court would need  
23 to approve that attorney.

24       I don't know that the Bank is prepared to name that person  
25 now. If so, it may be that Your Honor could approve that as

1 part of this order with no further action necessary. I don't  
2 know. The provision in the agreement says that it's done  
3 within 30 days, but if the Bank's prepared to do that we may be  
4 able to resolve that today.

5 MR. KNOWLES: Yes, Your Honor. The Bank is prepared  
6 to ask the Venable law firm and to ask me, in particular, to  
7 handle that investigation that's called for in the order. The  
8 Bank is comfortable with Venable conducting that review and if  
9 the Department of Justice has no objection to that, the Bank  
10 would like to put forward my name and my firm to conduct that  
11 review.

12 THE COURT: You don't have a conflict of interest in  
13 doing that?

14 MR. KNOWLES: We don't feel that we have a conflict of  
15 interest in doing that, Your Honor. We feel that we have --  
16 one of the things that I think --

17 THE COURT: You have an attorney-client relationship  
18 with the Bank.

19 MR. KNOWLES: We do.

20 THE COURT: And you have a fiduciary relationship with  
21 them as a result of that.

22 MR. KNOWLES: Right. But all --

23 THE COURT: The only --

24 MR. KNOWLES: -- we would be doing is making  
25 recommendations to the Bank's board of directors with regard to



1 the underlying conduct and any personnel decisions that would  
2 be made.

3 THE COURT: But you don't pretend to be impartial?

4 MR. KNOWLES: No. We are the Bank's counsel, that's  
5 correct.

6 THE COURT: Yeah.

7 MR. KNOWLES: But we do have a deep knowledge of the  
8 facts, the underlying facts and involvement and I think it  
9 would be far more expensive for the Bank to bring in outside  
10 counsel. We are not regular counsel for the Bank.

11 THE COURT: Right.

12 MR. KNOWLES: We were hired as special counsel for  
13 this matter. The Smith Anderson firm is their, is the Bank's  
14 outside general counsel.

15 THE COURT: And what are you going to do? Do an  
16 analysis and an audit of their lawfulness?

17 MR. KNOWLES: No. What we would do -- I think -- the  
18 purpose of this is, really, twofold in the agreement, as I  
19 understand, and Mr. Sweet can comment on this. One is to make  
20 sure that the particular conduct at issue does not occur in the  
21 future.

22 THE COURT: Suppose it does? Then what do you have --  
23 what's your duty? Aren't you put between the devil and the  
24 deep blue sea? I mean, suppose you get in there and you find  
25 that there's something objectionable going on. Do you have to

1 withdraw then or --

2 MR. KNOWLES: No. I think what we would be asked to  
3 do under the agreement is to make recommendations to the Bank's  
4 board of directors with regard to changes in conduct or  
5 activity or personnel.

6 So we would be doing that. We would be reporting to the  
7 Department of Justice on any changes in personnel. It would be  
8 a --

9 THE COURT: Even if they're unfavorable to your  
10 client?

11 MR. KNOWLES: Pardon?

12 THE COURT: Even if, if they are unfavorable to your  
13 client?

14 MR. KNOWLES: Well, individuals involved, for example,  
15 if particular employees were interviewed or otherwise, they  
16 would retain their own counsel. So they would be represented  
17 separately by their own counsel.

18 THE COURT: What, what is it about ethics that I am  
19 concerned about that no, that -- why am I the only one who sees  
20 this as a problem?

21 Do you see it as a problem?

22 MR. SWEET: Your Honor, we've discussed this with  
23 Mr. Knowles earlier. We, we recognize the potential. We also  
24 recognize the financial ties between the Bank -- let me step  
25 back for a moment.

1        This is not a case where we've tried the case or the firm  
2 has taken positions that everything was hunky-dory and  
3 everything's fine and nothing, nothing happened. So the  
4 Bank -- the attorneys for the Bank have -- the process they  
5 have had is, for the most part, to disclose information and try  
6 to explain the information and advocate for, for the client's  
7 interest without denying the conduct. I'm not, as it's a  
8 formal matter.

9        So we're not in a position where we doubt the firm's  
10 ability to perceive what occurred here and make recommendations  
11 to the board of directors for action. We have confidence the  
12 Bank can do that or the firm can do that and we also recognize  
13 that the firm has already a deep understanding of the facts --

14            THE COURT: Yeah.

15            MR. SWEET: -- and has been probing the facts. So  
16 there is some efficiency to it as well.

17            THE COURT: Yeah.

18            MR. SWEET: Your Honor, we don't, we're not going to  
19 take a position on this. We're not going to object if Your  
20 Honor believes that the Venable firm and Mr. Knowles are  
21 adequate to fulfill that, that purpose. This is the Bank's  
22 recommendation to Your Honor. The Government's not going to  
23 object. We do understand what you're raising, but in these  
24 particular circumstances we don't, we would not object on the  
25 basis of their existing relationship. As Mr. Knowles mentioned

1 as well, they're not regular counsel for the Bank. They were  
2 brought in for this specific purpose.

3 THE COURT: Yeah, but they're the Bank's lawyer. They  
4 have a professional obligation to seek the best interest of  
5 their client.

6 MR. BRINSON: Your Honor, I think the -- as I look at  
7 this, this is more of a potential conflict of interest than an  
8 actual conflict. The conflict, this potential would come down  
9 the road if there were some recommendation made that wasn't  
10 followed by the Bank, or something along those lines and I  
11 think that the, the law firm is taking a risk that if that  
12 potential conflict ripened into an actual conflict, they might  
13 be conflicted out of future representation of the Bank.

14 THE COURT: You call it a "potential." I call it the  
15 appearance of a conflict. There's -- the appearance is there  
16 that there's a conflict.

17 MR. SWEET: Your Honor, if I may, if we can then let  
18 this particular provision sit. 'Cause under this agreement the  
19 Bank has 90 days to or --

20 MR. ACKER: Up to 30 days.

21 MR. SWEET: -- 30 days to recommend and the Bank can  
22 submit papers in a brief and justification for why they believe  
23 whatever appointment they decide would --

24 THE COURT: Yeah.

25 MR. SWEET: -- be appropriate.

1 THE COURT: All right.

2 MR. SWEET: And it doesn't have to be decided now.

3 THE COURT: Okay.

4 MR. SWEET: It was just a possibility if Your Honor  
5 wanted to entertain that issue now. You raise some issues  
6 that, I think, we may want to take a closer look at it, too,  
7 but --

8 THE COURT: Okay.

9 MR. SWEET: -- I'll leave it at that.

10 THE COURT: Okay. Thank you.

11 Thank you all for a very thorough handling of the facts of  
12 the case and I'm grateful to hear all the information that I  
13 heard and I will look at the injunction and see about entering  
14 it.

15 So anyway, thank you. This was worthwhile.

16 MR. BRINSON: Thank you, Your Honor.

17 MR. SWEET: Thank you, Your Honor.

18 MR. KNOWLES: Thank you, Your Honor.

19 THE COURT: We'll be in recess.

20 THE COURTROOM DEPUTY: All rise. Court will be in  
21 recess.

22 (Proceedings concluded at 11:33 A.M.)

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CERTIFICATE OF COURT-APPROVED TRANSCRIBER

I, Janice Russell, court-approved transcriber, in and for the United States District Court for the Eastern District of North Carolina, do hereby certify that pursuant to Section 753, Title 28, United States Code, that the foregoing is a true and correct transcript from the official electronic sound recording of the proceedings in the above-entitled matter and that the transcript page format is in conformance with the regulations of the Judicial Conference of the United States.

Dated this 21st day of January, 2014.

/s/ JANICE RUSSELL  
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